Rebuttal Statement of Ken Casavant
June 30, 2005

1) I have been asked to review and comment on Dr. Keith Leffler's expert report of June 3, 2005.

2) As stated in my earlier report, I find nothing in the statutes under consideration in this case that requires, encourages, permits or facilitates concerted action in the marketplace and I have detected no sign of such action in my observations of the market. Dr. Leffler does not express any different conclusion. His report does not contain any reference to concerted action, nor does it contain any rationale under which he might argue that the statues permit or require concerted action. No rationale for concerted action and no reference to concerted action are in his report. He presents only a single reference to "cooperative" prices (which he does not define), without offering any reason why he thinks this term is an appropriate description of the pricing observed in the market. He does comment on "above-competitive" prices but it is significant that he does not refer to them as anti-competitive. Rather, the only thing Dr. Leffler says is that the prices are higher than they would be in a completely unregulated market. As presented in my earlier report, and below in this rebuttal report, prices in this market are higher than they would be in an unregulated market but there is no reason to believe this is due to anti-competitive conduct. To an economist, anti-competitive conduct means concerted or collusive action among competitors; it does not include two firms or people independently following the law. Dr. Leffler never makes this distinction. He seems to suggest that what he describes as above-competitive prices are the result of concerted or collusive conduct, but he makes no attempt to state any basis for that suggestion.

3) Dr. Leffler's assertion that transparent prices increase the likelihood of reaching and sustaining above-competitive prices flies in the face of competitive market theory and conventional wisdom. Economic experience teaches that the more prices are known and available to participants in the market, the more prices are driven toward costs of production or the floor set by regulatory constraints. The discussion in paragraph 16 of Dr. Leffler's report is reasonable until he states, "This has the effect of reducing the gain from such competitive efforts (*I am in full agreement*) and thereby reducing the incentive to ever engage in such actions". Firms in competition do receive the rewards from initiating a price change, if the price change correctly fits the market and the firm's sales goals. Because the current "posting" statute provides that prices remain confidential until they become effective, and all prices become effective on the same day, no competitor knows where a particular supplier or distributor is going

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to price its products until the prices take effect. Due to the "hold" regulation, competitors cannot react for 30 days so benefits do accrue to those firms correctly changing prices.

4) The "hold" requirement does make prices less volatile than they might be in an unregulated market. That means that competitors can neither raise nor lower their prices in response to market conditions as quickly as in an unregulated market. That also means that a competitor electing to cut prices will be able to enjoy the benefits of offering a lower price for longer than would be the case in an unregulated market.

5) Under the prior structure with prices being public information, firms would have an incentive to price high, knowing that they could respond in a certain time period to a competitor's lower price if it arose, and if it didn't, they got some short term benefits. Under the existing post and hold structure, firms profit seeking behavior is to price low to gain the advantage in the market place during the 30 day period when prices must be held; thus the current post and hold encourages profit seeking behavior with lower competitive prices being driven toward the floor as a result.

6) I do agree with Dr. Leffler that the effect of the "hold" for 30 days of posted prices is a decrease in the opportunity for short term sales promotions. This outcome fits the goals of the regulatory system of the State relative to constraining excessive promotion of alcohol consumption. When price variability and uncertainty exist in the market, consumers have shown they will react to sales promotions and purchase or consume more of the products being promoted. Making short term sales promotions less available to firms selling beer and wine has the effect of dampening excessive or abusive consumption..

7) I further agree, as an economist, that the regulatory structure overall increases the price and constrains access in the market. Among other impacts, it forestalls discount sales based on quantity discounts and credit provisions. Given the acknowledged significant price elasticity (responsiveness) of beer and wine, this helps moderate alcohol consumption and alcohol abuse. The 10% minimum markup, while not guaranteeing profit, constrains those that may want to "dump" a slow moving product or entice more consumption of the same product, again serving the goals of the State.

7) It is evident to me that the actions in the market are those of independent decision makers and Dr.Leffler does not suggest that they are not. Further, posting, due to its transparency, does not increase prices as suggested by Dr. Leffler, but rather causes competitive price movement toward the floor.

8) Dr. Leffler's overall point is that market efficiencies are lost and prices are higher than would be the case in a non-regulated market. I concur, but the real issue is whether the marginal increase in market efficiencies is worth the social

and public costs caused by the increase in alcohol abuse. Again, as an economist, I do not choose the level of public social costs to be considered by the legislature but it is clear that these costs are real and are imposed on society as a result of alcohol abuse. It is the role of the legislature to make those policy decisions.